

## **R865. Tax Commission, Auditing.**

### **R865-6F. Franchise Tax.**

#### **R865-6F-16. Apportionment of Income of Long-Term Construction Contractors Pursuant to Utah Code Ann. Sections 59-7-302 through 321.**

(1) When a taxpayer elects to use the percentage-of-completion method of accounting, or the completed contract method of accounting for long-term contracts, and has income from sources both within and without this state, the amount of business income derived from such long-term contracts from sources within this state is determined pursuant to this rule.

(2) Business income is apportioned to this state by a three-factor formula consisting of property, payroll, and sales--regardless of the method of accounting for long-term contracts elected by the taxpayer. The fraction by which business income shall be apportioned to the state shall be determined in accordance with rule R865-6F-8(4) and (7). Except as modified by this rule, the property factor shall be determined in accordance with R865-6F-8(8), the payroll factor in accordance with R865-6F-8(9), and the sales factor in accordance with R865-6F-8(10).

(a) Percentage-of-completion method. Under this method of accounting for long-term contracts, the amount included each year as business income from each contract is the amount by which the gross contract price (which corresponds to the percentage of the entire contract completed during the income years) exceeds all expenditures made during the income year in connection with the contract. Beginning and ending material and supplies inventories must be appropriately accounted for in reporting expenditures.

(b) Completed-contract method. Under this method of accounting, business income derived from long-term contracts is reported for the income year in which the contract is completed. A special computation is required to compute the amount of business income attributable to this state from each completed contract. All receipts and expenditures applicable to the contracts, whether complete or incomplete at the end of the income year, are excluded from other business income, which are apportioned by the regular three-factor formula of property, payroll, and sales.

(3) Property factor. In general, the numerator and denominator of the property factor is determined as set forth in Sections 59-7-312, 59-7-313, and 59-7-314 and the rules thereunder. However, the following special rules are also applicable:

(a) The average value of the taxpayer's cost (including materials and labor) of construction in progress, to the extent these costs exceed progress billings, are included in the denominator of the property factor. The value of those construction costs attributable to construction projects in this state are included in the numerator of the property factor. It may be necessary to use monthly averages if yearly averages do not properly reflect the average value of the taxpayer's equity.

(b) Rent paid for the use of equipment directly attributable to a particular construction project is included in the property factor at eight times the net annual rental rate, even though the rental expense may be capitalized into the cost of construction.

(c) The property factor is computed in the same manner for all long-term-contract methods of accounting and is computed for each income year, even though under the completed-contract method of accounting business income is computed separately.

(4) Payroll factor. In general, the numerator and denominator of the payroll factor are determined as set forth in Sections 59-7-315 and 59-7-316 and the rules thereunder. However, the following special rules are also applicable.

(a) Compensation paid to employees attributable to a particular construction project is

included in the payroll factor even though capitalized into the cost of construction.

(b) Compensation paid to employees who, in the aggregate, perform most of their services in a state to which their employer does not report them for unemployment tax purposes, is attributed to the state where the services are performed. For example, a taxpayer engaged in a long-term contract in State X sends several key employees to that state to supervise the project. The taxpayer, for unemployment tax purposes reports these employees to State Y where the main office is maintained and where the employees reside. For payroll factor purposes and in accordance with Section 59-7-316 and the rule thereunder, the compensation is assigned to the numerator of State X.

(c) The payroll factor is computed in the same manner for all long-term-contract methods of accounting and is computed for each income year, even though under the completed contract method of accounting, business income is computed separately.

(5) Sales Factor. In general, the numerator and denominator of the sales factor shall be determined as set forth in Sections 59-7-317, 59-7-318, and 59-7-319 and the rules thereunder. However, the following special rules are also applicable.

(a) Gross receipts derived from the performance of a contract are attributable to this state if the construction project is located in this state. If the construction project is located partly within and partly without this state, the gross receipts attributable to this state are based upon the ratio which construction costs for the project in this state incurred during the coming year bears to the total of such construction costs for the entire project during the income year. Progress billings are ordinarily used to reflect gross receipts and must be shown in both the numerator and denominator of the sales factor.

(b) If the percentage-of-completion method is used, the sales factor includes only that portion of the gross contract price which corresponds to the percentage of the entire contract which was completed during the income year. For example, a construction contractor which had elected the percentage-of-completion method of accounting entered into a \$9,000,000 long-term construction contract. At the end of its current income year (the second since starting the project) it estimated that the project was 30 percent completed. The amount of gross receipts included in the sales factor for the current income year is \$2,700,000 (30 percent of \$9,000,000), regardless of whether the taxpayer uses the accrual method or the cash method of accounting for receipts and disbursements.

(c) If the completed-contract method of accounting is used, the sales factor includes the portion of the gross receipts (progress billings) received under the cash basis or accrued, whichever is applicable, during the income year attributable to each contract. For example, a construction contractor which elected the completed-contract method of accounting entered into a long-term construction contract. At the end of its current income year (the second since starting the project) it had billed, and accrued on its books a total of \$5,000,000 of which \$2,000,000 had accrued in the first year the contract was undertaken, and \$3,000,000 in the current (second) year. The amount of gross receipts included in the sales factor for the current income year is \$3,000,000. If the taxpayer keeps its books on the cash basis, and as of the end of its current income year has received only \$2,500,000 of the \$3,000,000 billed during the current year, the amount of gross receipts to be included in the sales factor for the current year is \$2,500,000.

(d) The sales factor, except as noted above in Subsections (5)(b) and (c), is computed in the same manner for all long-term contract methods of accounting and is computed for each income year--even though under the completed-contract method of accounting, business income

is computed separately. (6) The completed-contract method of accounting provides that the reporting of income (or loss) is deferred until the year the construction project is completed. In order to determine the amount of income which is attributable to sources within this state, a separate computation is made for each contract completed during the income year, regardless of whether the project is located within or without this state. The amount of income from each contract completed during the income year apportioned to this state is added to other business income apportioned to this state by the regular three-factor formula, and that total together with all nonbusiness income allocated to this state becomes the measure of tax for the income year. The amount of income (or loss) from each contract which is derived from sources within this state using the completed-contract method of accounting is computed as follows.

(a) In the income year the contract is completed, the income (or loss) therefrom is determined.

(b) The income (or loss) determined at Subsection (6)(a) is apportioned to this state by the following method:

(i) a fraction is determined for each year the contract was in progress (the numerator of which is the amount of construction costs paid or accrued each year the contract was in progress, and the denominator of which is the total of all construction costs for the project);

(ii) each fraction determined in Subsection (6)(b)(i) is multiplied by the apportionment formula percentage for that particular year;

(iii) these factors are totaled; and

(iv) the total income is multiplied by this combined percentage, and the resulting income (or loss) is the amount of contract business income assigned to this state.

(c) A corporation using the completed-contract method of accounting is required to include income derived from sources within this state from contracts within or without this state or income from incomplete contracts in progress outside this state in the year of withdrawal, dissolution, or cessation of business pursuant to Subsection (6)(d).

(d) The amount of income (or loss) from each such contract apportioned to this state is determined as if the percentage-of-completion method of accounting were used for all such contracts on the date of withdrawal, dissolution, or cessation of business. The amount of business income (or loss) for each such contract is the amount by which the gross contract price from each such contract from the commencement thereof to the date of withdrawal, dissolution, or cessation of business exceeds all expenditures made during such period in connection with each such contract. Beginning and ending material and supplies inventories must be appropriately accounted for in reporting expenditures in connection with each contract.

**KEY: taxation, franchises, historic preservation, trucking industries**

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